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The Past and Future of Kentucky's Fraudulent Transfer and Preference Laws

BY DOUGLAS C. MICHAEL*

INTRODUCTION

An important part of the law of creditors' remedies is the ability of creditors to recover property formerly held by the debtor, but transferred to others under circumstances that are considered to be unfair or inequitable. There are two principal ways a creditor can seek to have a debtor's transfer characterized as unfair in order to recover it. First, a transfer to another creditor or a third party can be fraudulent as to one or all of the remaining creditors, or may be deemed to be fraudulent

* Professor of Law, University of Kentucky. A.B. 1979, Stanford University; M.B.A. 1982, J.D. 1983, University of California at Berkeley. I am indebted to the following people who helped guide my research. First, to my colleagues at other schools who helped with the history and meaning of these otherwise obscure laws, particularly Jim Bowers, Boyce Covington, Fred Hart, Bruce Markell, and Ray Warner. Second, to Jerry Hartzell of the North Carolina Bar, who was good enough to update me on recent developments in that state and provide a copy of the Bar Association report. Third, to John McCabe at the National Conference of Commissioners on Uniform State Laws, who provided updates and insights on the uniform law adoption process. Finally, to members of the Kentucky Bar who provided information on practice experience and their evaluations of the Kentucky laws, particularly Thomas Canary, Joan Cooper, Susan Hoffman, Jack Reisz, Robert Treadway, and Tracey Wise. Although this article would not have been possible without them, they are of course in no way responsible for anything that is wrong with it.

The footnotes in this Article do not conform to Rule 1.2 of the Sixteenth Edition of *THE BLUEBOOK: A UNIFORM SYSTEM OF CITATION* with regard to the use of *see* signals, but rather follow the rule that was set out in previous editions.

because of the circumstances surrounding the transfer, such as a transfer made by an insolvent debtor for less than fair value. Second, even a transfer to another creditor for full value can be considered "preferential" to that creditor. Recovery of a preferential transfer to one creditor, in theory, makes all of the debtor's property available for an orderly distribution to all creditors. Fraudulent transfers and preferences are recoverable in state law collective actions such as assignments for the benefit of creditors, or in a proceeding under the federal Bankruptcy Code (Code).¹

Kentucky has a unique and antique collection of laws governing fraudulent transfers and preferences. Both the singularity and age of these laws are easily established with a few examples. The most recent of these laws were written 140 years ago.² Kentucky is one of only eight states that have not adopted one of two uniform laws offered on the subjects in the past ninety years.³ In addition, Kentucky is one of only three states allowing creditors to set aside preferences,⁴ a power reserved otherwise for bankruptcy or other insolvency proceedings. Indeed, most other states have declared their policy to permit preferences, almost as a fundamental right of debtors to pay any debts they might have at any time, regardless of the effect on other creditors.⁵

This background suggests that Kentucky's singularity is perhaps not a good thing, but rather evidence of old laws left to languish long past their time. In Part I of this article, I review the development of modern fraudulent transfer and preference law. Part II contrasts that development with the existing law in Kentucky and other non-uniform states. Part III reviews the need and prospects for reform of Kentucky's laws. I conclude that in most respects improvement and modernization is overdue, but should proceed carefully with due regard taken of the effect of broadly written fraudulent transfer statutes on commercial transactions.

I. DEVELOPMENT OF FRAUDULENT TRANSFER AND PREFERENCE LAW IN THE UNITED STATES

Although the laws of fraudulent transfers and preferences are treated together in modern legal analyses, they have distinct ancestries. Each will be discussed here in turn.

¹ 11 U.S.C. §§ 101-1330 (1994).

² See *infra* note 84 and accompanying text.

³ See *infra* note 115 and accompanying text.

⁴ See *infra* notes 36-38 and accompanying text.

⁵ See *infra* note 177 and accompanying text.

A. *Fraudulent Transfers*

Almost all fraudulent transfer law in the United States claims as its origin the 1571 Statute of Elizabeth.⁶ Although this was intended to be primarily a penal statute, and was originally a temporary law, it was almost immediately extended by Parliament and interpreted by the courts to allow creditors to avoid transfers by a debtor made with the intent to defraud them or to hinder or delay their ability to recover from a debtor.⁷ In the United States, almost all states either accepted this rule as part of the received common law or expressly adopted it by statute.⁸ Because the courts found early on that actual fraudulent intent was difficult to prove, the common law relied on more objective indicia of fraud, known as “badges of fraud,” to distinguish culpable transfers from the innocent.⁹

The addition by courts of badges of fraud, although helpful in individual cases, had by the early part of this century created so much confusion that the National Conference of Commissioners on Uniform State Laws (NCCUSL) noted that “[t]here are few legal subjects where there is a greater lack of exact definitions and clear understanding of

⁶ 13 Eliz. c. 5 (1571). The original statute provided in part for the avoidance of: feigned, covinous and fraudulent Feoffments, Gifts, Grants, Alienations, Conveyances, Bonds, Suits, Judgments and Executions, as well of Lands and Tenaments as of Goods and Chattels, . . . [w]hich . . . have been and are devised and contrived of Malice, Fraud, Covin, Collusion or Guile, to the End, Purpose and Intent, to delay, hinder or defraud Creditors and others of their just and lawful Actions

Id. § I. There was an exception for *bona fide* transfers “upon good Consideration.” *Id.* § VI.

⁷ See 1 GARRARD GLENN, *FRAUDULENT CONVEYANCES AND PREFERENCES* 79 (rev. ed. 1940). The Statute of Elizabeth is much more complicated than this simple text *supra* note 6 indicates, and has a history at least as fascinating as that of the law developed since its enactment; see *id.* at 81-99.

⁸ *Id.* at 79-80; Peter A. Alces & Luther M. Dorr, Jr., *A Critical Analysis of the New Uniform Fraudulent Transfer Act*, 1985 U. ILL. L. REV. 527, 530. The exception is Louisiana, whose law is based in the Roman law of revocation, which is very different in terminology but similar in result. See Bruce V. Schewe, *Debtors in Solido: On Plain Language and Uncertainty with Mention of the Revocatory Action*, 32 LOYOLA L. REV. 13, 38-44 (1986); *infra* note 125 (discussing Louisiana law).

⁹ See PETER A. ALCES, *THE LAW OF FRAUDULENT TRANSACTIONS*, at 5-12, 5-32 to -45 (1989); 1 GLENN, *supra* note 7, at 532-33; Alces & Dorr, *supra* note 8, at 530-31; Frank R. Kennedy, *The Uniform Fraudulent Transfer Act*, 18 UCC L.J. 195, 196 (1986).

boundaries."¹⁰ To remedy this situation, the NCCUSL adopted the Uniform Fraudulent Conveyance Act (UFCA) in 1918.¹¹ The UFCA improved the existing common law by providing more objective measures of fraud, focusing on the effect on creditors of the transfer.¹² Thus, in addition to transfers made with the always-difficult-to-prove intent to defraud, the UFCA deemed fraudulent any transfer made by a debtor, without receipt of fair consideration, if the debtor would be insolvent or have insufficient assets to pay remaining obligations as they matured.¹³

The UFCA was not intended to be a comprehensive treatment of fraudulent transfer law,¹⁴ but was successful as far as it went, being adopted by twenty-five states.¹⁵ In addition, it was largely incorporated into federal bankruptcy law.¹⁶ When that law was completely rewritten as the Bankruptcy Code in 1978, so too were the provisions governing fraudulent transfers. In order to update the now-outdated UFCA to reflect this and other changes,¹⁷ the NCCUSL adopted the Uniform Fraudulent Transfer Act (UFTA) in 1984.¹⁸ The UFTA has had more immediate and near-universal acceptance, having been adopted in thirty-seven states and the District of Columbia to date,¹⁹ and five states have retained the UFCA.²⁰ This leaves only eight states (including Kentucky) without a uniform act.

The improvements made by the UFCA, the UFTA, and the Code over the received English law are well-recognized.²¹ While the modern laws still retain the creditor's ability to void a transfer made with actual intent to defraud, they now permit creditors to recover in other situations as well.

¹⁰ UNIF. FRAUDULENT CONVEYANCE ACT [hereinafter UFCA], 7A U.L.A. 428 (1985) (Prefatory Note).

¹¹ See *id.* at 427.

¹² ALCES, *supra* note 9, at 5-12; Kennedy, *supra* note 9, at 197.

¹³ See generally UFCA §§ 4-6, 7A U.L.A. 474-509 (1985).

¹⁴ See 1 GLENN, *supra* note 7, at 101.

¹⁵ See 7A U.L.A. 427 (1985).

¹⁶ *Id.*; ALCES, *supra* note 9, at 5-13; Kennedy, *supra* note 9, at 196.

¹⁷ See ALCES, *supra* note 9, at 5-15; Kennedy, *supra* note 9, at 198-99.

¹⁸ 7A U.L.A. 639 (1985).

¹⁹ *Id.* at 217 (Supp. 1997) (listing 36 states and the District of Columbia). North Carolina became the 37th Uniform Fraudulent Transfer Act (UFTA) state in 1997. See 1997 N.C. Adv. Legis. Serv. Pamphlet No. 4, at 28 (passed July 1, 1997).

²⁰ 7A U.L.A. 159 (Supp. 1997) (Table).

²¹ See ALCES, *supra* note 9, at 5-12; 1 GLENN, *supra* note 7, at 100; Kennedy, *supra* note 9, at 196. See *infra* Part III.A for a complete discussion of the benefits and drawbacks of the UFTA.

These include transfers by debtors who are, or will shortly be, insolvent,²² and certain preferential transfers by “insiders” of the debtor as well.²³ Adding these objective measures of “constructive fraud” makes the statutes more responsive to the modern commercial environment²⁴ by providing more certainty for lenders, borrowers, and their counsel.

B. Preferences

The history of the law of preferences, judge-made in its early years but later the subject of much legislation, is well-told by Professor Glenn.²⁵ Today, most states permit recovery in a liquidation proceeding of recent preferential payments by specific debtors engaged in regulated industries, primarily insurance companies²⁶ and financial institutions.²⁷ There also are assorted statutes applying the same rule to liquidations of other business associations.²⁸ Preferences also are often recoverable under state law if the debtor later makes a general assignment for the benefit of creditors.²⁹ These

²² See *supra* text accompanying note 13; 11 U.S.C. § 548 (1994).

²³ See UFTA § 5(b), 7A U.L.A. 657 (1985); 11 U.S.C. §§ 547, 550(c) (1985).

²⁴ This was one of the major objectives of the UFCA. See Alces & Dorr, *supra* note 8, at 533.

²⁵ See 2 GLENN, *supra* note 7, at 646-80.

²⁶ Statutes permitting recovery of preferences during a period (usually four months) before receivership or liquidation of an insurance company exist in almost all states. See, e.g., KY. REV. STAT. ANN. § 304.33-310 (Michie 1996); CAL. INS. CODE § 1034 (1993); IND. CODE § 27-9-3-16 (1994); N.Y. INS. LAW § 7425 (McKinney 1985); OHIO REV. CODE ANN. § 3903.28 (Anderson 1996); TENN. CODE ANN. § 56-9-317 (1994); TEX. INS. CODE ANN. § 21.28(5)(a) (West 1981); VA. CODE ANN. § 38.2-1513 (Michie 1994); W. VA. CODE §§ 33-10.26, 33-24.33 (1996); see also REFERENCE HANDBOOK ON INSURANCE COMPANY INSOLVENCY 27-28 (Cynthia J. Borrelli ed., 3d ed. 1993) (providing § 28 of the National Ass’n of Insurance Commissioners’ Insurers Supervision, Rehabilitation and Liquidation Model Act).

²⁷ As to national banks, see 12 U.S.C. § 91 (1994); as to state financial institutions, see 3 MICHIE ON BANKS AND BANKING 224-27 (1996) and 1 MILTON R. SCHROEDER, THE LAW AND REGULATION OF FINANCIAL INSTITUTIONS 12-76 (1995).

²⁸ See, e.g., FLA. STAT. ANN. § 440.386 (West 1991) (workers’ compensation for self-insured employers); GA. CODE ANN. § 14-9A-129 (1994) (limited partnerships); IOWA CODE §§ 523A.22, 523I.5 (West 1988) (funeral homes and cemeteries); WASH. REV. CODE § 23.72.020 (1994) (corporations).

²⁹ STEFAN A. RIESENFELD, CREDITORS’ REMEDIES AND DEBTORS’ PROTECTION 431 (4th ed. 1987) (“[M]any states [have] enacted statutes proscribing preferences

statutes, though they are applied in diverse situations, have in common the avoidance of preferences given just before an insolvency or liquidation. Such payments are more likely to be unfair than an "ordinary course" preference since the debtor is in financial trouble and it is more likely that one creditor will be fully paid while others of an identical priority will remain unpaid. The development of such a rule seems sensible, though it was long in coming to English law.³⁰ It parallels, of course, the similar provision in the Code permitting avoidance of preferences by trustees.³¹

There is in addition the federal priority statute which is not a preference law, but rather gives claims of the federal government first priority in certain cases involving transfers by insolvents.³² A companion provision permits recovery from a debtor's representative of a preferential payment by that representative.³³ These provisions, like the statutes discussed above, focus on collective proceedings, implicitly in the case of the priority rule³⁴ and explicitly in the case of recovery from a debtor's representative.³⁵

The avoidance at state law of a preferential payment outside of these relatively limited circumstances is permitted only in three states: Ken-

in the form of, or in conjunction with, . . . [general] assignments. . ."). In addition, at least two states convert a partial assignment for the benefit of creditors into a general assignment. *See* OKLA. STAT. ANN., tit. 24, § 31 (West 1987); 39 PA. STAT. ANN. § 2 (West 1954); RIESENFELD, *supra*, at 441.

³⁰ 2 GLENN, *supra* note 7, at 654.

³¹ *See* 11 U.S.C. § 547 (1994).

³² *See* 31 U.S.C. § 3713(a) (1994) (providing for first priority of a federal claim if a person is insolvent and assigns property or has property attached, or if a decedent's estate is insufficient to pay all claims). The statute also gives the federal claim priority if an "act of bankruptcy" is committed, a concept no longer part of bankruptcy law, but nonetheless "a vital part of the Insolvency Statute." *Carter v. Carter*, 681 F. Supp. 323, 326 (E.D. Va. 1988).

³³ 31 U.S.C. § 3713(b) (making the representative liable to the extent any other claim is paid before the federal claim).

³⁴ *See* William T. Plumb, Jr., *The Federal Priority in Insolvency: Proposals for Reform*, 70 MICH. L. REV. 1, 14 (1971) ("[A] statutory rule of priority that creates no lien but simply provides the order of distribution of the debtor's assets is appropriately applicable only in collective proceedings involving administration of all or substantially all of a debtor's assets . . .").

³⁵ The person referred to in § 3713(b) is one "into whose hands control and possession of the debtor's assets are placed [and who is] responsible for seeing that the Government's priority is paid." *King v. United States*, 379 U.S. 329, 337 (1964).

tucky,³⁶ New Mexico,³⁷ and Ohio.³⁸ Other writers have mentioned Maryland³⁹ and Pennsylvania⁴⁰ statutes in this context, but both of those states' statutes can be distinguished from the inquiry at hand. The Maryland statute appears to apply by its terms only to a state law assignment or receivership, and is thus not a general anti-preference statute, but rather the kind of statute discussed above.⁴¹ The same is true with one of the Pennsylvania statutes.⁴² The other Pennsylvania statute provides in relevant part that "a debtor may assign any part of his estate to *certain creditors*, or in trust for them, if at the time of so doing he be solvent, or the same be not in contravention of the other provisions of this act."⁴³ Although this language appears general in nature, Pennsylvania courts have never interpreted the emphasized portion of this statute to be a general anti-preference statute. On the contrary, preferences even by insolvents have been upheld.⁴⁴ North Dakota and South Dakota criminalize preferential payments by insolvent debtors, but say nothing more.⁴⁵

³⁶ See KY. REV. STAT. ANN. § 378.060 (Michie 1972).

³⁷ See N.M. STAT. ANN. § 56-9-1 (Michie 1996).

³⁸ See OHIO REV. CODE ANN. § 1313.56 (Anderson 1993).

³⁹ See Thomas D. Buckley, *The Use of Ohio's Preference Law in Bankruptcy: An Alternative to Section 547 With a Longer "Reach-Back" Period*, 20 CAP. U. L. REV. 863, 863 & n.1 (1991) (citing MD. CODE ANN., COM. LAW § 15-101(d) (1990)).

⁴⁰ See RIESENFELD, *supra* note 29, at 441 (citing 39 PA. STAT. ANN. § 2 (West 1954)); William S. Tribell, Comment, *The Effect of the National Bankruptcy Act on Kentucky's General Assignment Law*, 41 KY. L.J. 450, 453 & n.15 (1952-53) (citing 39 PA. STAT. ANN. § 152 (West 1954)).

⁴¹ See *supra* note 28.

⁴² See 39 PA. STAT. ANN. § 152 (West 1954) (providing for avoidance of preferences given within four months of a general assignment for the benefit of creditors).

⁴³ *Id.* § 2 (emphasis supplied).

⁴⁴ See, e.g., *Rorison v. Davey*, 49 A.2d 357, 359-60 (Pa. 1946); *Schimmel v. Cohen*, 118 A. 735 (Pa. 1922) ("[A] man may prefer one creditor over another if he sees fit to do so, and the mere fact of such preference will not invalidate the transaction in the absence of an allegation and proof of fraud."); *Commonwealth Nat'l Bank v. Miller*, 437 A.2d 1012, 1014 (Pa. Super. Ct. 1981) ("This state has long held that there is no fraud involved in the preference of one creditor over another, even if the preferred creditor and debtor agree in the full knowledge that other creditors will be left unpaid.").

⁴⁵ See N.D. CENT. CODE § 13-01-13 (1991); S.D. CODIFIED LAWS § 54-8-21 (Michie 1996).

In these three states – Kentucky, Ohio, and New Mexico – a transfer made with a “design to prefer” one creditor is avoidable.⁴⁶ This language of intent was originally meant to distinguish payments to creditors made under pressure or threat, which presumably bore no such intent, from those payments made voluntarily, which first became voidable outside of bankruptcy by common law decisions traced back to 1758.⁴⁷ It appears, therefore, that a transfer made with a “design to prefer” is roughly what the courts that coined the phrase would call a transfer made “for no other good reason.”⁴⁸ This history has long been forgotten, however, and it would be completely irrelevant but for the fact that “phrases like ‘intent to prefer’ crop up here and there in our statutes, and would be confusing did we not know that, like a vermiform appendix, this terminology shows that there was once a thing which meant a good deal.”⁴⁹ However, because this appendix remains viable in Kentucky, we must deal with the confusion that results when courts try to breathe common-law life into statutory language with little modern importance.⁵⁰

There is a different history of the preference within, as opposed to outside, a bankruptcy or insolvency proceeding. The history of the preference in bankruptcy is also well-told by Professors Glenn⁵¹ and Countryman.⁵² It began as a judge-made rule intended to address “‘a fraud upon the bankrupt laws.’”⁵³ Eventually, however, the avoidable preference became virtually a “no-fault” phenomenon, devoid, at least in the current Code language, of any requirement of proof of intent by the debtor or knowledge of any intent by the creditor.⁵⁴ This evolutionary history is important, however, because it shows that during the mid-nineteenth century, when the state preference laws were being enacted, the preference was like a fraudulent transfer, though not at once the same.⁵⁵ It seems that the confusion of that time was incorporated into state laws of the day, and

⁴⁶ See *supra* notes 36-38.

⁴⁷ 2 GLENN, *supra* note 7, at 654 & n.22 (citing cases).

⁴⁸ My own language.

⁴⁹ 2 GLENN, *supra* note 7, at 656.

⁵⁰ See *infra* Part II.A.2.

⁵¹ See 2 GLENN, *supra* note 7, at 681-732.

⁵² See Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713 (1985).

⁵³ 2 GLENN, *supra* note 7, at 656 (quoting Lord Mansfield in *Worseley v. DeMattoos*, 1 Burr. 467 (1758)).

⁵⁴ This entire development is well-documented in Countryman, *supra* note 52, at 718-32.

⁵⁵ See 2 GLENN, *supra* note 7, at 656-57; Countryman, *supra* note 52, at 718-21.

notwithstanding the Code's modernization, has been there frozen in place in these three states retaining these ancient laws.

II. DEVELOPMENT OF NON-UNIFORM FRAUDULENT TRANSFER AND PREFERENCE LAW

This Part describes, against the background of the general history of development of these laws discussed in Part I, the specific development of Kentucky law and surveys briefly the status of these laws in the other seven non-uniform states.

A. Kentucky

1. *Fraudulent Transfers*

In 1796, Kentucky passed a statute copied largely from the Statute of Elizabeth, declaring void every transfer "contrived of malice, fraud, covin, collusion or guile to the intent or purpose to delay, hinder or defraud creditors of their just and lawful actions."⁵⁶ This language was substantially modified in 1851,⁵⁷ and an important provision was added permitting avoidance of gifts by debtors.⁵⁸ In 1896, a new section was added dispensing with the requirement of an unsatisfied execution in actions to set aside conveyances of real property.⁵⁹ The language remains otherwise unchanged

⁵⁶ 1796 Ky. Acts, c. 255, § 2 (1809). This language obviously is copied from the Statute of Elizabeth. *Cf. supra* note 6. Like that statute, there is an exception for *bona fide* transfers upon good consideration. *See* 1796 Ky. Acts, c. 255, § 3. This Act also covered other transfers. It avoided gratuitous transfers of property unless accompanied by a transfer of possession. And in cases of loans of personal property for more than five years without demand for return and transfers of personal property with any reservation, the act provided that, as against creditors, "the absolute property is with the possession." *Id.* § 2.

⁵⁷ *See* 1850 Ky. Acts, c. 617, c. 26 §§ 1-4 (1851). This Act also made heirs and devisees liable for debts of the testator. *See id.* §§ 5-10.

⁵⁸ "Every gift, conveyance, assignment, transfer, or charge made by a debtor, of or upon any of his estate, without valuable consideration therefor, shall be void . . ." *Id.* § 2. Fraudulent transfers could be avoided by all "creditors, purchasers, or other persons," *id.* § 1, but transfers by debtors without consideration could be avoided only by present creditors, *id.* § 2. These are, of course, the ancestors of KY. REV. STAT. ANN. §§ 378.010 and 378.020 (Michie 1972); *see infra* note 59.

⁵⁹ *See* 1896 Ky. Acts, c. 7 (1896) (codified at KY. REV. STAT. ANN. § 378.030). One writer has suggested that only a judgment need be required in any case

today.⁶⁰ Thus, although the statutory law of fraudulent transfers provides several avenues of recovery for creditors, the most significant and most frequently used are the two permitting avoidance of: (1) transfers made with intent to defraud⁶¹ and (2) gifts by debtors.⁶² Judicial developments under each are discussed in turn below.

a. Transfers with Intent to Defraud

After the passage of the Statute of Elizabeth, English courts struggled to separate fraudulent transfers from the innocent, developing "badges of fraud" as guideposts.⁶³ Kentucky courts have done the same with our version of the statute. Facts or actions of the debtor labeled as badges of fraud include transfers to relatives, false statements regarding consideration, transfers after or in anticipation of litigation against the transferor, transfer of all or most of the transferor's assets, and the insolvency of the

(involving real or personal property). See Arloe W. Mayne, Comment, *Creditors' Bills and Actions to Set Aside Fraudulent Conveyances – Prerequisites to Suit*, 39 KY. L.J. 103 (1950-51). No requirement of prior execution was included in the UFCA.

⁶⁰ A typographical change was made in 1852. See 1851 Ky. Acts, c. 358, c. 59 (1852). The entire provision was reenacted in 1892. See 1891-1893 Ky. Acts, c. 119, §§ 1-4 (1892). As amended in 1896, see *supra* note 58, these provisions became §§ 1906-1909 of Carroll's Kentucky Statutes and thence KY. REV. STAT. ANN. §§ 378.010-.050. See KY. REV. STAT. (1944) (Disposition Table).

⁶¹ See KY. REV. STAT. ANN. § 378.010 (Michie 1972), which provides that: Every gift, conveyance, assignment or transfer of, or charge upon, any estate, real or personal, or right or thing in action, or any rent or profit thereof, made with the intent to delay, hinder or defraud creditors, purchasers or other persons, and every bond or other evidence of debt given, action commenced or judgment suffered, with like intent, shall be void as against such creditors, purchasers and other persons. This section shall not affect the title of a purchaser for a valuable consideration, unless it appears that he had notice of the fraudulent intent of his immediate grantor or of the fraud rendering void the title of such grantor.

⁶² See *id.* § 378.020, which provides that:

Every gift, conveyance, assignment, transfer or charge made by a debtor, or of upon any of his estate without valuable consideration therefor, shall be void as to all his then existing creditors, but shall not, on that account alone, be void as to creditors whose claims are thereafter contracted, nor as to purchasers from the debtor with notice of the voluntary alienation or charge.

⁶³ See *supra* note 8 and accompanying text.

transferor.⁶⁴ It is well-settled that the effect of the plaintiff's proof of one or more of these badges of fraud is to shift to the defendant the burden of proving lack of fraudulent intent.⁶⁵ Other factors akin to badges of fraud are listed in the statute elsewhere.⁶⁶

Once such a conveyance is proved, the statute provides that it "shall be void," but not as against "a purchaser for a valuable consideration, unless it appears that he had notice of the fraudulent intent of his immediate grantor or of the fraud rendering void the title of such grantor."⁶⁷ Kentucky courts have made various interpretations of this requirement for creditors attempting to pursue the transferee of the debtor's property. "Valuable consideration" under the statute may be found unless the value and the consideration are "disproportionate."⁶⁸ If such disparity is absent, courts move to the more difficult second element of "notice" of the fraud. Some courts have said that notice by the transferee can be established by the same proof that shows the transaction was fraudulent to the creditor.⁶⁹ In *Trent v. Carroll*,⁷⁰ the court established that lack of notice under the statute is similar to a finding of good faith on the part of the transferee, which

⁶⁴ See *Russell Co. Feed Mill, Inc. v. Kimbler*, 520 S.W.2d 309, 311 (Ky. 1975); *Trent v. Carroll*, 380 S.W.2d 87, 89 (Ky. 1964); *Magic City Coal & Feed Co. v. Lewis*, 175 S.W. 992, 993-94 (Ky. 1915). "Insolvency" when used as a badge of fraud is not well-defined by the courts, but is presumably a "balance sheet" test. See, e.g., *Russell Co. Feed Mill*, 520 S.W.2d at 312 (debtor had no assets); *Hayes v. Rodgers*, 447 S.W.2d 597, 600 (Ky. 1969) (creditors' remedies had been pursued without success); *Hardy v. Peoples State Bank & Trust Co.*, 229 S.W.2d 771, 772 (Ky. 1950) (listing other indebtedness of debtor).

⁶⁵ See *Magic City*, 175 S.W. at 993. Even in 1915, the court was able to cite six cases on this point. See also *Russell Co. Feed Mill*, 520 S.W.2d at 312 (finding it error to grant defendant's motion for a directed verdict where plaintiff had proved badges of fraud and defendant did not respond); *Hayes*, 447 S.W.2d at 600 (describing the burden on the defendant as one of "proving good faith"); *Farmers' Bank & Trust Co. v. Peters*, 11 S.W.2d 103, 104-05 (Ky. 1928) (holding that defendant's proof of valuable past consideration for transfer satisfied the burden of proof that was shifted to it by plaintiff's proof of badges of fraud).

⁶⁶ See KY. REV. STAT. ANN. § 378.020 (Michie 1972) (gifts by debtors, discussed *infra* Part II.A.1.b); *id.* § 378.040 (conveyance of personal property without delivery); *id.* § 378.050 (loan of personal property for five years without demand for return).

⁶⁷ *Id.* § 378.010.

⁶⁸ *McKenzie v. Oliver*, 571 S.W.2d 102, 107 (Ky. Ct. App. 1978).

⁶⁹ See, e.g., *Harlin v. Calvert's Adm'x*, 70 S.W.2d 524 (Ky. 1934).

⁷⁰ *Trent v. Carroll*, 380 S.W.2d 87 (Ky. 1964).

depends “upon the sufficiency and reasonableness of his inquiry.”⁷¹ A few months later, however, the court decided in *Interstate Acceptance Corp. v. Lovins*⁷² that the purchaser there was not put on inquiry notice by the circumstances of the transaction, and the court intimated that it is unlikely that such a duty could ever be found.⁷³ The court stated broadly that “the buyer is not the guardian of the seller’s creditors,”⁷⁴ a statement that diminishes significantly any duty on the part of transferees and shows, in opposition to the language of the statute, “a tension that runs throughout the law of fraudulent dispositions.”⁷⁵

b. Gifts by Debtors

One badge of fraud so singular as to warrant separate treatment is lack of consideration received by a transferor. Although not mentioned in the Statute of Elizabeth,⁷⁶ the idea of attacking gratuitous transfers quickly took root in this country.⁷⁷ Indeed, the first Kentucky statute on the subject

⁷¹ *Id.* at 90.

⁷² *Interstate Acceptance Corp. v. Lovins*, 380 S.W.2d 805 (Ky. 1964).

⁷³ Regarding this duty of inquiry, the court noted:

Inquiry about what? That the [debtors] had creditors? Any going business has creditors. . . . Inquiry about the amount of indebtedness to [the creditor]? . . . Had such inquiry been made it would have disclosed a sharply fluctuating creditor-debtor relationship which had apparently been satisfactory to [the creditor] over a long period of years. Inquiry about the intentions of [the debtors] with respect to their plans to liquidate their obligations? We know of no rule of law or reason to require such a course of action and obviously a debtor would not disclose anything inimical to his interests.

Id. at 808. Although *Trent* was decided before *Lovins*, the *Trent* opinion was modified on denial of rehearing two weeks after *Lovins* was decided, with no mention of it. *Trent* probably can be distinguished on its facts, however, as the court noted there that the transferee’s testimony “indicates strongly that he thought he could color the transaction with good faith by a title search and by reliance on [the debtor], who was tainted with fraud.” *Trent*, 380 S.W.2d at 90. It appears, then, that the transferee in *Trent* had actually made an inquiry and terminated it prematurely when it began producing uncomfortable evidence.

⁷⁴ *Lovins*, 380 S.W.2d at 808.

⁷⁵ ALCES, *supra* note 9, at 5-35 (discussing *Lovins*).

⁷⁶ *See id.* at 5-33; 1 GLENN, *supra* note 7, at 455.

⁷⁷ *See* 1 GLENN, *supra* note 7, at 456-57.

permitted avoidance of gratuitous transfers without limitation,⁷⁸ and although there was a split in the law in the early nineteenth century, the view prevailed that lack of consideration was alone not a ground for attack unless the transferor was also insolvent.⁷⁹ Otherwise, it would be possible “in theory, at least, [that] the Christmas presents of every indebted person [would be] . . . subject to attack by creditors regardless of any circumstances tending to show good faith and due regard for the interest of creditors when the gifts were made.”⁸⁰

Nonetheless, the minority view remained the law in Kentucky. Early in the Commonwealth’s history, the courts made clear that the statute required no proof of anything other than lack of consideration.⁸¹ Although “[i]f carried to its ultimate consequences even the most trivial indebtedness would be sufficient to avoid the voluntary conveyance,”⁸² the statute and the rule remain unchanged today. Indeed, a prefatory note to the UFCA in 1918 referred to the “sharp conflict” on the issue of an insolvency requirement, noting that Kentucky was one jurisdiction “which adhere[s] to an early rule of great severity.”⁸³

2. Preferences

Kentucky’s preference law is of comparatively recent origin, dating from 1856.⁸⁴ It makes any transfer by a debtor “in contemplation of insolvency and with the design to prefer one or more creditors to the exclusion in whole or in part of others” operate as an assignment for the benefit of all creditors.⁸⁵ The statute remains, with minor changes, as it was written on enactment.⁸⁶

⁷⁸ See *supra* note 58.

⁷⁹ See 1 GLENN, *supra* note 7, at 458-60.

⁸⁰ James Angell McLaughlin, *Application of the Uniform Fraudulent Conveyance Act*, 46 HARV. L. REV. 404, 407-08 (1932-33).

⁸¹ James M. Marks, Comment, *Kentucky’s Obsolete Law on Gifts by Debtors*, 39 KY. L.J. 456, 456-57 (1950-51).

⁸² *Id.* at 457.

⁸³ 7A U.L.A. 428 (1985) (Prefatory Note to the UFCA).

⁸⁴ See 1855 Ky. Acts, ch. 704 (1856).

⁸⁵ *Id.* § 1 (codified at KY. REV. STAT. ANN. § 378.060 (Michie 1972)).

⁸⁶ The 1892 recodification, see *supra* note 60, added “every judgment suffered” to the list of potentially preferential transfers, and provided new priorities for distribution of the assets of the estate. See 1891-1893 Ky. Acts, ch. 119, §§ 5, 11 (1892). These provisions became sections 1910-1917 of Carroll’s Kentucky

Judicial interpretation of this statute has attempted to operate between two extremes. On the one hand, surely *all* payments to creditors do not work an assignment for the benefit of all creditors. On the other hand, a payment made "with the design to prefer" the creditor ought not be synonymous with fraud, otherwise the statute simply duplicates the fraudulent transfer law.

The fact of the debtor's insolvency⁸⁷ is often held to raise the presumption of a design to prefer,⁸⁸ and occasionally the presumption is absolute.⁸⁹ The debtor's insolvency is proved even if it is the debtor's fervent hope that solvency exists⁹⁰ or is imminent.⁹¹ Some hint of what "the design to prefer" might be comes from a case holding an inter-family transfer to have such a design.⁹² In another, the court holds that the debtor's intention to avoid bankruptcy is insufficient to rebut the above presumption,⁹³ but goes on to state in dictum what might be a transfer without design, noting that "[t]his is not a case of a struggling debtor, who uses a portion of his property to discharge pressing debts, in the honest belief that he might continue in business, and thereafter was forced into insolvency."⁹⁴ Or, as another case stated in dictum: "Of course a debtor cannot prefer one creditor over another, but if his conveyances are made in good faith, for a valuable

Statutes and thence KY. REV. STAT. ANN. §§ 378.060-.090. *See* KY. REV. STAT. (1944) (Disposition Table).

⁸⁷ Insolvency here, as in the case of the fraudulent transfer statute, *see supra* note 64, is determined by a "balance sheet" test, so far as the cases make clear. *See* Frankfort Builders Supply Co. v. Pollard, 305 S.W.2d 110, 112 (Ky. 1957); Terrell v. Cheatham, 255 S.W. 262, 263-64 (Ky. 1923).

⁸⁸ *See* Bomanzi of Lexington, Inc. v. Tafel, 415 S.W.2d 627, 630 (Ky. 1967); Greathouse v. Millard, 320 S.W.2d 630, 632 (Ky. 1958) ("designed to prefer"); Finan v. Finan's Trustee, 57 S.W.2d 644, 645 (Ky. 1933); Union Trust & Savings Co. of Maysville v. Taylor, 134 S.W. 196, 197 (Ky. 1911).

⁸⁹ *See* McKinney Deposit Bank v. Cyrus W. Scott Mfg. Co., 269 S.W. 343, 344 (Ky. 1924).

⁹⁰ *See* Terrell, 255 S.W. at 263-64 (debtor's belief in value of assets held not reasonable in light of demands of security by other creditors).

⁹¹ *See* Goodloe v. Buckner, 32 S.W. 135, 136 (Ky. 1895) ("The expectations of [debtor], although honest and sincere, cannot avail [him] in this case.").

⁹² *See* Rains' Trustee v. Rains, 3 S.W.2d 1065, 1066 (Ky. 1928).

⁹³ *See* Finan, 57 S.W.2d at 645.

⁹⁴ *Id.*

consideration, and without design to hinder or delay his creditors, the transfer will not be disturbed.”⁹⁵

As the last quote demonstrates by mixing in the language of the fraudulent transfer law, there remains in Kentucky courts significant confusion over the status of the preference as a separate, non-fraudulent conveyance. Many opinions have lumped both together as “fraud” statutes,⁹⁶ while others maintained that the preference statute has nothing to do with fraud.⁹⁷ It is important in this context to recall that the initial purpose of the “intent” or “design” to prefer was to separate transfers made with no other reason from those made under duress or threat of retribution in some fashion other than that provided by the law of creditors’ remedies. For example, a transfer coerced by a creditor who has threatened to sue or foreclose would not have such an intent or design, but presumably a transfer coerced by a creditor who threatened other harm would have such an intent or design.⁹⁸

Kentucky courts have fashioned exceptions to the statute, analogous to the more familiar exceptions in the Code. If the transfer occurs at the same time as the value is given by the creditor to the debtor, no preference will be found.⁹⁹ Preferential transfers to otherwise fully secured creditors have

⁹⁵ *Hickman Bank & Trust Co. v. Pickard & Mayberry*, 270 S.W. 30, 32 (Ky. 1925).

⁹⁶ *See Greathouse v. Millard*, 320 S.W.2d 630, 632 (Ky. 1958) (using “badges of fraud” as evidence supporting intent to prefer); *Kincaid v. Brown’s Estate*, 262 S.W.2d 468, 473 (Ky. 1953) (discussing both the fraudulent transfer and preference statutes and noting that it is “not the nature or form of the transaction, but the presence of fraud which brings a case within the terms of the statutes”); *S.J. Marx Co.’s Trustee v. Marx*, 3 S.W.2d 644, 646 (Ky. 1928).

⁹⁷ *See Lyon v. Harris*, 121 S.W.2d 696, 697 (Ky. 1938) (holding that a transfer not proven to be fraudulent would nonetheless be actionable as a preference, but the preference statute was not pled); *Farmers’ Bank of Fountain Run v. Hagan*, 46 S.W.2d 1084, 1087 (Ky. 1932); *Hord v. Green*, 44 S.W.2d 549, 551 (Ky. 1931) (stating that “[t]hese provisions are to be read together,” and then proceeding to show the differences between them); *Farmers’ Bank & Trust Co. v. Peters*, 11 S.W.2d 103, 105 (Ky. 1928) (same conclusion as in *Lyon*, 121 S.W.2d at 696).

⁹⁸ *See supra* note 47 and accompanying text.

⁹⁹ *See Frankfort Builders Supply Co. v. Pollard*, 305 S.W.2d 110, 111 (Ky. 1957); *Linn v. Brown*, 206 S.W. 287, 289 (Ky. 1918); *see also Reed v. Shirley*, 271 S.W. 73, 74 (Ky. 1925) (holding a preference actionable because it was made by an insolvent and not on account of a “debt or liability created simultaneously with it”). *Cf.* 11 U.S.C. § 547(b)(2) & (c)(1) (1994).

been held not actionable.¹⁰⁰ And preferential transfers of exempt property are not actionable under the Kentucky statute.¹⁰¹

If a preference has been found and no exceptions are made, the statute provides that the preferential transfer shall operate as an assignment for the benefit of all creditors, in which all creditors may participate, and which shall be administered according to the rules governing decedents' estates.¹⁰² This language persists despite the later enactment of a comprehensive general assignment statute.¹⁰³ Even though the statute mentions no other relief, recovery of money has been allowed.¹⁰⁴

3. *Effect of These Statutes Under the Bankruptcy Code*

Both the Kentucky fraudulent transfer and anti-preference statutes are available to the trustee in bankruptcy according to Code § 544(b). Both statutes have potential for greater recovery for the estate, since they have longer "reach-back" periods than their federal counterparts. The Code's fraudulent transfer provision reaches back only one year,¹⁰⁵ but courts have held that the Kentucky statute has a five-year statute of limitations, with the period beginning only on discovery of the fraud.¹⁰⁶ The Code's preference

¹⁰⁰ See *Jackson v. Coons*, 147 S.W.2d 45, 47 (Ky. 1941); *Young v. Fidelity & Columbia Trust Co.*, 79 S.W.2d 944, 947 (Ky. 1935); see also *Greathouse v. Millard*, 320 S.W.2d 630, 632 (Ky. 1958) (holding that transfers were preferential because the creditor was *no longer secured* when the transfers were made); *Terrell v. Cheatham*, 255 S.W. 262, 264 (Ky. 1923) (dictum). Cf. 11 U.S.C. § 547(b)(5) (1994) (providing that to be actionable, a transfer must, if recovered, allow a creditor to receive more in liquidation than would have been received otherwise; this requirement is normally not met in the case of transfers to previously fully secured creditors).

¹⁰¹ See *Kessler v. Tapp*, 180 S.W.2d 552, 554 (Ky. 1944); *Tewmeyer v. Tewmeyer's Assignee*, 65 S.W.2d 479, 480 (Ky. 1933) (citing cases). Cf. 5 COLLIER ON BANKRUPTCY 547-21 (rev. 15th ed. 1997) (same result under the Bankruptcy Code).

¹⁰² See KY. REV. STAT. ANN. §§ 378.060-.070 (Michie 1972).

¹⁰³ See *id.* §§ 379.010-.170 (Michie 1972 & Supp. 1996) (discussed *infra* notes 179-83 and accompanying text).

¹⁰⁴ See *Bomanzi of Lexington, Inc. v. Tafel*, 415 S.W.2d 627, 631 (Ky. 1967).

¹⁰⁵ See 11 U.S.C. § 548(a) (1994).

¹⁰⁶ See *Pergrem v. Smith*, 255 S.W.2d 42, 43-44 (Ky. 1953); *Gillardi v. Henry*, 113 S.W. 2d 1158, 1162 (Ky. 1938); *Moore v. Shepherd*, 225 S.W. 484, 486 (Ky. 1920). The limitation period is provided by KY. REV. STAT. ANN. § 413.120(11) (Michie 1992) (establishing five-year limitation for actions based on fraud); *id.*

“reach-back” period is three months,¹⁰⁷ while the Kentucky anti-preference statute provides a six-month period.¹⁰⁸ In bankruptcy, however, this limitation is replaced by Code § 546(a), which allows more time once the bankruptcy petition is filed.¹⁰⁹ Court decisions have made clear that there is no preemption problem here; the state statute supplements rather than contradicts the federal provisions.¹¹⁰

The Kentucky anti-preference statute, so far as sparse cases have indicated, may provide a unique opportunity for a trustee to have the best of all worlds in a bankruptcy proceeding. An initial literal reading of the statutes together would suggest that the trustee obtains, under Code § 544(b), the right of an actual creditor under state law – that is, to participate in a general assignment for the benefit of all creditors,¹¹¹ hardly a valuable right once in bankruptcy. Thus, at least one court has held, and most others have assumed, that the right under Code § 544(b) includes the

§ 413.130(3) (providing that cause of action does not accrue until discovery of fraud, but may not in any event be brought more than 10 years after the perpetration of the fraud).

¹⁰⁷ See 11 U.S.C. § 547(b)(4) (1994) (providing that a transfer to be avoided must be made on or within 90 days of filing the petition for relief, or within one year in the case of transfers to insider-creditors).

¹⁰⁸ See KY. REV. STAT. ANN. § 378.070(1) (Michie 1972).

¹⁰⁹ See *In re Wilson*, 106 B.R. 125, 126 (Bankr. W.D. Ky. 1989); *In re Scott-Frederick Motor Co.*, 177 F. Supp. 758, 760 (E.D. Ky. 1959). The Code provides that an action under § 544(b) must be brought within two years after the entry of the order for relief, or one year after the appointment of a trustee (if any), whichever is later, but in any event no later than the time the case is closed or dismissed. See 11 U.S.C. § 546(a) (1994). The court in *In re Baird*, 63 B.R. 60, 63 (Bankr. W.D. Ky. 1986), held that 11 U.S.C. § 108(c) would apply, but that section refers only to actions against the debtor, which is never the case in an action to set aside a fraudulent transfer or preference. See *In re Wilson*, 106 B.R. at 126.

¹¹⁰ See RIESENFELD, *supra* note 29, at 435 & n.44 (citing *Stellwagen v. Clum*, 245 U.S. 605 (1918)). *Stellwagen* upheld the predecessor to OHIO REV. CODE ANN. § 1313.56 (Anderson 1993), which is nearly identical to the Kentucky statute. See KY. REV. STAT. ANN. § 378.060; see also *In re Rexplere Drilling, Inc.*, 971 F.2d 1219, 1222 (6th Cir. 1992). But see *id.* at 1225-26 (Merritt, C.J., dissenting) (arguing that there is a preemption problem because “the time limits and the substance of the Kentucky preference statute are flatly inconsistent with the preference provisions of the Bankruptcy Act, 11 U.S.C. § 547.”). Neither the *Rexplere* opinion nor the dissent discusses *Stellwagen*.

¹¹¹ See KY. REV. STAT. ANN. § 378.060 (providing that the preferential payment “shall operate as an assignment and transfer of all the property of the debtor, and shall inure to the benefit of all his creditors”).

right to *avoid* the transfer.¹¹² In another expansive reading of the remedy provided in the combination of these two statutes, a court has held that the trustee need not find an actual creditor in existence at the time of the preferential payment, as Code § 544(b) otherwise requires,¹¹³ because the trustee *became* such a creditor by operation of state law as soon as the preference was given.¹¹⁴

B. Other Non-Uniform States

1. Fraudulent Transfers

The states remaining outside the uniform fold (in addition to Kentucky) are Alaska, Georgia, Kansas, Louisiana, Mississippi, South Carolina, and Virginia.¹¹⁵ If there is uniformity in this assortment, it is in the presence in six of these states of Statute-of-Elizabeth-type laws declaring fraudulent transfers void,¹¹⁶ each excepting transfers made to bona fide purchasers

¹¹² See *Kessler v. Tapp*, 180 S.W.2d 552, 553-54 (Ky. 1944) (involving an action under the National Bankruptcy Act § 110(e), the predecessor to 11 U.S.C. § 544(b)). Under this law, the court would later hold in another case that a creditor proving a voidable preference may have that creditor's pro rata share in a money judgment. See *supra* note 104 and accompanying text.

¹¹³ See 11 U.S.C. § 544(b) (permitting the trustee to avoid any transfer "that is voidable under applicable law *by a creditor holding an unsecured claim*") (emphasis supplied).

¹¹⁴ See *In re Scott-Frederick Motor Co.*, 177 F. Supp. 758, 760 (E.D. Ky. 1959); see also KY. REV. STAT. ANN. § 378.060 (providing that the preference operates as an assignment for the benefit of all creditors "including those which are future and contingent").

¹¹⁵ See 7A U.L.A. 427 (1985) & 217 (Supp. 1997) (tables of adoptions of UFCA and UFTA). North Carolina recently left this list. See *supra* note 19. The alert reader can see a geographical trend here. Southeastern states generally are perceived by some as slower to adopt uniform laws. Telephone Interview with John McCabe, Legislative Coordinator, National Conference of Commissioners on Uniform State Laws ("NCCUSL") (Aug. 15, 1997).

¹¹⁶ See ALASKA STAT. § 34.40.010 (Michie 1986); GA. CODE ANN. § 18-2-22(2) (1991); KAN. STAT. ANN. § 33-102 (1993); MISS. CODE ANN. § 15-3-3 (1995); S.C. CODE ANN. § 27-23-10 (Law. Co-op. 1991); VA. CODE ANN. § 55-80 (Michie 1995). The South Carolina statute even retains the Statute of Elizabeth's penal provisions, imposing a penalty of loss of one year's value, half to be paid to the state. See S.C. CODE ANN. § 27-23-30 (Law. Co-op. 1991). In Louisiana, a transfer that increases a debtor's insolvency can be avoided without regard to fraud. See LA.

without notice of the fraud.¹¹⁷ There is more limited consensus, in four states, avoiding conveyances by an insolvent debtor.¹¹⁸ A few of these states have provisions similar to Kentucky's avoiding an unrecorded conveyance of personal property without change of possession¹¹⁹ and loans of property without demand for return by the lender within a certain period of time.¹²⁰

Many of the same problems evident in Kentucky's experience with old statutory provisions have surfaced in these other jurisdictions. The language of the Georgia statute, prohibiting fraudulent transfers as well as gifts by insolvent debtors,¹²¹ has been interpreted in a confusing fashion in some cases.¹²² The South Carolina statute has been criticized for retaining

CIV. CODE ANN. arts. 2036, 2038 (West 1987); *see also infra* note 125 (discussing Louisiana law).

¹¹⁷ *See* ALASKA STAT. § 34.40.100 (Michie 1986); GA. CODE ANN. § 18-2-22(2) (1991); MISS. CODE ANN. § 15-3-5 (1995); S.C. CODE ANN. § 27-23-40 (Law. Co-op. 1991); VA. CODE ANN. § 55-80 (Michie 1995). In Kansas, the same result obtains by judicial decision. *See, e.g.,* Gorham State Bank v. Sellens, 772 P.2d 793, 797 (Kan. 1989) ("[T]he rights of innocent third parties such as bona fide purchasers for value, without notice or knowledge of any fraud, are fully protected under our decisions. . . ."); City of Arkansas City v. Anderson, 804 P.2d 1026, 1031 (Kan. Ct. App. 1991) ("[A] bona fide purchaser for value will obtain good title, notwithstanding an earlier fraudulent transfer. . . ."). In Louisiana, the transfer can be avoided even from a purchaser for value and without knowledge, but "in that case that person is entitled to recover as much as he gave." LA. CIV. CODE ANN. art. 2038 (West 1987).

¹¹⁸ *See* GA. CODE ANN. § 18-2-22(3) (1991); LA. CIV. CODE ANN. art. 2039 (West 1987); MISS. CODE ANN. § 15-3-3 (1995) (no insolvency requirement); VA. CODE ANN. § 55-81 (Michie 1995).

¹¹⁹ *Compare* KY. REV. STAT. ANN. § 378.040 with ALASKA STAT. § 9.25.060 (Michie 1996); KAN. STAT. ANN. § 33-103 (1993); MISS. CODE ANN. § 15-3-3 (1995) (both real and personal property covered, but only if transfers made without consideration); *and* S.C. CODE ANN. § 27-23-70 (Law. Co-op. 1991) (gifts of personal property made without change of possession). The Alaska and Kansas statutes except, as does the Kentucky statute, retention of possession of personal property in accordance with § 2-402(2) of the Uniform Commercial Code.

¹²⁰ *Compare* KY. REV. STAT. ANN. § 378.050 with KAN. STAT. ANN. § 33-104 (1993) (five years); MISS. CODE ANN. § 15-3-3 (1995) (three years); *and* VA. CODE ANN. § 55-87 (Michie 1995) (five years).

¹²¹ *See* GA. CODE ANN. § 18-2-22(2) (1991) (fraudulent transfers); *id.* § 18-2-22(3) (transfers without consideration by insolvents).

¹²² *See Developments in Georgia Law: Debtor-Creditor Rights*, 12 GA. L. REV. 814, 1026, 1034 (1978).

the inefficient requirement of an unsatisfied levy or execution.¹²³ In Virginia, the Statute-of-Elizabeth language was used to reach a preference paid by a corporation to an insider, with resulting confusion between preference and fraudulent conveyance law.¹²⁴ Revisions to Louisiana law in 1984 are more in keeping with the uniform acts.¹²⁵

Reform efforts have continued. The UFTA was introduced (but not passed) in 1997 in Kansas and Mississippi.¹²⁶ Several formerly non-uniform states have recently adopted the UFTA,¹²⁷ and their reports indicate that adoption continues to be based on the advantages of the uniform acts that have inhered since their first writing.¹²⁸ North Carolina, which adopted the UFTA in 1997,¹²⁹ previously had a Statute-of-Elizabeth-type law that "was

¹²³ See Samuel L. Wilkins, *Annual Survey of South Carolina Law: Property*, 34 S.C. L. REV. 193, 198-99 (1982). The same problem may exist, at least as to personal property, in Kentucky; see *supra* note 59.

¹²⁴ See Joseph E. Ulrich, *Fraudulent Conveyances and Preferences in Virginia*, 36 WASH. & LEE L. REV. 51 (1979) (discussing *Bank of Commerce v. Rosemary & Thyme, Inc.*, 239 S.E.2d 909 (Va. 1978) and *Darden v. George G. Lee Co.*, 129 S.E.2d 897 (Va. 1963)). Professor Ulrich's criticism is that the confusion generated by the Virginia Supreme Court in these two cases might have been avoided under the UFTA, which provides for a separate avenue of recovery for preferences to insiders wholly apart from the fraudulent transfer actions in the rest of the act. See UFTA § 5(b), 7A U.L.A. 657-58 (1985).

¹²⁵ See LA. CIV. CODE art. 2036 (West 1987). This statute calls the revocatory action, "the civil law analogue to the common law suit to set aside a fraudulent conveyance." *Id.* cmt. (c). See also Benjamin M. Goodman, Comment, *The Revocatory Action*, 9 TUL. L. REV. 422, 422 (1934-35) ("The basic requirement of a successful revocatory action is fraud on the part of the debtor."). However, the Louisiana statute as enacted in 1984 by its terms abandons any notion of fraud, stating simply, "An obligee has a right to annul an act of the obligor . . . that causes or increases the obligor's insolvency." LA. CIV. CODE art. 2036 (West 1987). See also *id.* cmt. (a) (stating that this provision "changes the law insofar as it abandons the notion of fraud"); see generally Schewe, *supra* note 8, at 39-44. Thus, the Louisiana statute allows recovery for constructively fraudulent transfers in a fashion similar to the UFTA.

¹²⁶ Telephone Interview with John McCabe, *supra* note 115.

¹²⁷ States recently adopting the UFTA without having previously adopted the UFCA are Missouri (1992), Indiana (1994), Iowa (1994), Vermont (1996), and North Carolina (1997). Other Kentucky neighbors did the same but not as recently: Illinois (1989) and West Virginia (1986). See 7A U.L.A. 427 (1985) & 217 (Supp. 1997) (tables of adoptions of UFCA and UFTA).

¹²⁸ See *supra* notes 21-24 and accompanying text.

¹²⁹ See *supra* note 19.

written in archaic language and was difficult to interpret.”¹³⁰ An earlier review of North Carolina law urged adoption of the UFCA, noting that it would “substitute clear, relatively simple statutory provisions for the complex, confusing and sometimes strained interpretations of the present North Carolina statutes.”¹³¹ Indiana, which adopted the UFTA in 1994,¹³² previously had statutory and common law that “put in doubt the role of insolvency in finding a fraudulent transfer” and “[made] it perilous for Indiana attorneys to counsel clients on the possible effect of such common-place transactions as foreclosures and leveraged buyouts.”¹³³ Illinois, which adopted the UFTA in 1989,¹³⁴ previously had difficulty reconciling the provisions on fraudulent transfers with those on gifts by insolvent debtors. Reviewers there noted that, under the old non-uniform law,

[a] reading of . . . cases does not allay confusion. Courts concluding that the debtor’s intent was fraudulent could have just as easily concluded that his intent was innocent. The statutory language does not provide any guidelines so that a debtor and creditor can determine whether a proposed payment will survive judicial scrutiny.¹³⁵

Similarly, when the UFTA was adopted in Missouri in 1992, one practitioner noted that “[c]reditors in Missouri will no longer be forced to accept the inadequacies of archaic and outdated fraudulent conveyance provisions.”¹³⁶

2. Preferences

The other states with a general anti-preference law like Kentucky’s are New Mexico and Ohio.¹³⁷ In New Mexico, aside from an early case

¹³⁰ Commentary by The North Carolina Bar Ass’n 1 (1997) (copy on file with author).

¹³¹ E. Cader Howard, Comment, *The Law of Fraudulent Conveyances in North Carolina: An Analysis and Comparison with the Uniform Fraudulent Conveyances Act*, 50 N.C. L. REV. 873, 902 (1972).

¹³² See 7A U.L.A. 217 (Supp. 1997) (table of adoption of UFTA).

¹³³ *Report of the Debtor-Creditor Committee of the Indiana State Bar Association Reporting on and Recommending Adoption of the Indiana Uniform Fraudulent Transfer Act*, 28 IND. L. REV. 1197, 1202 (1995) [hereinafter *Indiana State Bar Ass’n Report*].

¹³⁴ See *supra* note 132.

¹³⁵ Darrell Dunham & Paul Antonacci, *An Analysis of Fraudulent Preferences Under Illinois Fraudulent Conveyances Law*, 12 S. ILL. U. L.J. 89, 115 (1987).

¹³⁶ Francis X. Buckley, Jr., *The Missouri Uniform Fraudulent Transfer Act*, 50 J. MO. B. 89, 93 (1994).

¹³⁷ See *supra* notes 36-38 and accompanying text.

interpreting the statute carefully and literally,¹³⁸ reported decisions show that courts or counsel have apparently ignored or overlooked it. In one case, the court held that, despite the statute's language, there is a right of a debtor to prefer one creditor over others.¹³⁹ And in two other cases, the court noted that the statute had been overlooked by the parties.¹⁴⁰

In Ohio, the confusion between fraudulent transfers and preferences has reached the statutory level. One section of the statute permits avoidance both of preferences and fraudulent transfers,¹⁴¹ and a second section, added later, provides that there is no avoidance unless the transferee "knew of such fraudulent intent on the part of such debtor."¹⁴² This language could be read to mean that fraudulent intent is required in preference actions. Although the Ohio Supreme Court resolved this question in a "reasonable but textually strained" fashion, limiting "fraudulent intent" to mean "intent to prefer" when a preference was in fact involved,¹⁴³ later opinions continue

¹³⁸ In *Early Times Distillery Co. v. Zeiger*, 49 P. 723 (N.M. 1897), the court held that a preference in violation of the statute operates as an assignment in trust, so that any other creditor may proceed to make and prove a claim before the court of equity, which has jurisdiction instantly upon the making of the preference. *Id.* at 725.

¹³⁹ See *Marchbanks v. McCullough*, 132 P.2d 426, 429 (N.M. 1942) ("[T]here is no law which prevents a preference of one creditor over another . . . if the transfer is not in fact made with the intent and purpose of hindering, delaying or defrauding any creditor; notwithstanding the transferer may be insolvent." (citations omitted)).

¹⁴⁰ See *Smith v. Cox*, 831 P.2d 981, 983 n.1 (N.M. 1992) ("While we recognize that . . . [the anti-preference statute] specifically addresses questions of preferential transfers, we have omitted any discussion of this statute because the parties failed to raise it at any time . . ."); *Field v. Otero*, 255 P. 785, 786 (N.M. 1927) ("[A]side from the restrictions of the Bankruptcy Law, or local insolvency laws, neither of which has been invoked in this case, there is no law which prevents a preference of one creditor over another."). I am indebted to Professor Fred Hart for citing me to the *Otero* case.

¹⁴¹ See OHIO REV. CODE ANN. § 1313.56 (Anderson 1993).

¹⁴² *Id.* § 1313.57. Although the recognizable predecessor of § 1313.56 dates from 1859, the predecessor to § 1313.57 was passed in 1902. See Buckley, *supra* note 39, at 871-76.

¹⁴³ Buckley, *supra* note 39, at 887-88 (discussing *Carruthers v. Kennedy*, 166 N.E. 801 (Ohio 1929)). Although the statutory language is clear, the court in *Carruthers* noted that:

a larger degree of moral turpitude is involved in a transaction with intent to hinder, delay, and defraud creditors than is involved in a transaction with a design to prefer one or more creditors to the exclusion of others, and we

to show that the confusion spawned by these statutes lives on.¹⁴⁴ The Ohio anti-preference statute is useful primarily in bankruptcy cases because it provides a longer “reach-back” period than the federal statute.¹⁴⁵ Unlike the Kentucky and New Mexico statutes, the Ohio statute apparently allows a creditor to avoid a preference outside of a collective proceeding for the benefit of all creditors.¹⁴⁶ That is of little use, however, because such a recovery would simply be another preference avoidable by another creditor in a perhaps endless chain of such actions.¹⁴⁷

III. EVALUATION OF KENTUCKY LAW IN COMPARISON TO THE EVOLVING NATIONAL STANDARDS

Given this background of the development of fraudulent transfer and preference laws, this Part evaluates Kentucky’s laws in light of the experiences of other states. Again, the fraudulent transfer and preference laws are separated for individual discussion, followed by an analysis of the impact of reform on lawyers’ ethical obligations.

A. *Fraudulent Transfers*

It is apparent that the Kentucky fraudulent transfer law offers few if any advantages when compared with the UFTA. The UFTA and its predecessor both are recognized as codifying the “better decisions” under the Statute of Elizabeth.¹⁴⁸ In addition, both the UFCA and UFTA provided recovery for creditors for transfers constructively fraudulent; that is,

can see no possible reason why the Legislature should protect one and fail to protect the other.

Carruthers, 166 N.E. at 803.

¹⁴⁴ See, e.g., *Toledo Trust Co. v. Foxhall Partners*, No. L-89-036, 1990 WL 7974, at *6 (Ohio Ct. App. Feb. 2, 1990) (holding that, in a case involving only a preferential transfer, “the requirements of [§] 1313.57 would still not be met, as there is no evidence showing that the appellee knew of any fraudulent intent” on the part of the debtor).

¹⁴⁵ See Buckley, *supra* note 39, at 894.

¹⁴⁶ See OHIO REV. CODE ANN. § 1313.56 (Anderson 1993) (“In a suit brought by a creditor . . . for the purpose of declaring such a sale void, a receiver *may* be appointed . . .” (Emphasis added)). This was read to permit a plenary lawsuit for the recovery of money paid as a preference in *Malone v. Summer & Co.*, 244 N.E.2d 485, 488 (Ohio Ct. App. 1968).

¹⁴⁷ See 2 GLENN, *supra* note 7, at 651; Buckley, *supra* note 39, at 895 & n.103.

¹⁴⁸ UFTA, 7A U.L.A. 639 (1985) (Prefatory Note).

transfers by debtors for inadequate consideration that left the debtors thereby insolvent or nearly so. Both these are recognized by virtually all commentators as vast improvements over the preexisting common law.¹⁴⁹ The unusual Kentucky provision avoiding gifts without regard to insolvency¹⁵⁰ would not be duplicated under the UFTA, but that statute has been long-recognized as a relic without modern purpose.¹⁵¹ The UFTA has the additional advantage of renewed harmony with federal bankruptcy law.¹⁵² There is little reason to have different rules under state law,¹⁵³ apparently apart from a longer limitation period.

To be sure, the UFTA is not without its critics. The most significant overall criticism of the UFTA is that it reaches too broadly and is ineffective where it tries to be specific. The problem with drafting fraudulent conveyance law in general is that the language can suffer from being at once too general and too specific, allowing escape from the desired result, since fraud, whether actual or deemed, takes so many forms.

A statutory proscription of particular transactions or of transactions with particular consequences must offer a catalog of indicia to signal reliably those transfers that invidiously sacrifice some interests in favor of others. The laws must hold the "dirty guys" in without unduly inhibiting the regularity and predictability of commercial transactions. Achieving the best balance of general and specific terminology to assure commercially reasonable results is a significant challenge.¹⁵⁴

In addition, fraudulent conveyance law that strays too far from the ordinary cases leads to inefficiency because creditors can always add terms to their

¹⁴⁹ See *supra* note 21 and accompanying text.

¹⁵⁰ See KY. REV. STAT. ANN. § 378.020 (Michie 1972).

¹⁵¹ See Marks, *supra* note 81, at 459 (advocating enactment of the UFCA to "remove the stigma of a doctrine early placed in Kentucky's laws by the blind following of [New York precedent] and which rests on no more than the highly dubious rationale 'that a person must be just before he is generous'").

¹⁵² This was one of the reasons for the UFTA. See UFTA, 7A U.L.A. 639 (1985) (Prefatory Note); Kennedy, *supra* note 9, at 198-99.

¹⁵³ This was recognized with the promulgation of the UFCA in 1918:

Business at the present time largely disregards state lines, and it is important for a creditor in giving credit to know, what degree he can rely on the property of his debtor, though it is situated in another state. The Bankruptcy Act . . . strongly emphasizes the desirability of this, which even apart from that Act would be important.

UFCA, 7A U.L.A. 427 (1985) (Prefatory Note).

¹⁵⁴ Alces & Dorr, *supra* note 8, at 549.

contract individually, but it would require the collective consent of all of them to opt out of a statutory provision. Thus, going beyond the obvious “shams” and gifts by insolvent debtors may create more problems than it solves.¹⁵⁵

The main specific criticisms of the UFTA focus on the timing of a transfer¹⁵⁶ and definitions of terms, “insolvency” in particular.¹⁵⁷ A second point of contention is the avoidance of an insider preference under UFTA § 5(b).¹⁵⁸ This is the only provision of the UFTA permitting avoidance of a transfer without any requirement of a lack of a reasonably equivalent value received in exchange or of an intent to defraud.¹⁵⁹ Not only does this language again vacillate between the general and the precise,¹⁶⁰ it makes the choice to risk catching “good-faith” insiders, assuming that such transferees will be few and far between.¹⁶¹ Many states have differed with the

¹⁵⁵ See Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 836-40 (1985). The argument of Professors Baird and Jackson is, of course, directed at fraudulent transfer law generally, and loses some force when discussing state law in the shadow of 11 U.S.C. § 548, which already ventures far down the path that Baird and Jackson suggest should be tread lightly.

¹⁵⁶ See Paul M. Shupack, *Confusion in Policy and Language in the Uniform Fraudulent Transfer Act*, 9 CARDOZO L. REV. 811, 820-23 (1987).

¹⁵⁷ See *id.* at 823-35; Alces & Dorr, *supra* note 8, at 558-63 (discussing the difficulty with using insolvency as a measuring criterion at all in cases of upstream or cross-stream guarantees and leveraged buyouts); Barry L. Zaretsky, *Fraudulent Transfer Law as the Arbiter of Unreasonable Risk*, 46 S.C. L. REV. 1165, 1177-99 (1995) (suggesting the use of “unreasonable risk” analysis in such cases).

¹⁵⁸ That subsection provides:

A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent.

UFTA, 7A U.L.A. 657 (1985).

¹⁵⁹ All transfers deemed fraudulent by §§ 4(a)(2) and 5(a) require that the debtor did not receive reasonably equivalent value in exchange. The only other transfers avoidable by the Act are those made under § 4(a)(1) “with actual intent to hinder, delay, or defraud.” *Id.* § 4(a)(1).

¹⁶⁰ The term “insider” is defined in § 1(7) in great detail, but only with examples, and the entire insider preference avoidance depends on the insider’s “reasonable cause to believe” in the debtor’s solvency or insolvency. *Id.* § 5(b); see generally Alces & Dorr, *supra* note 8, at 551-57.

¹⁶¹ See Michael L. Cook & Richard E. Mendales, *The Uniform Fraudulent Transfer Act: An Introductory Critique*, 62 AM. BANKR. L.J. 87, 88-89 (1988).

NCCUSL on this point; two have reinstated the requirement of a lack of reasonably equivalent value,¹⁶² and four have omitted the subsection altogether.¹⁶³ The report of the Indiana Bar Association on the UFTA provides well-reasoned arguments for omitting this provision,¹⁶⁴ and should be seriously considered in any Kentucky study of the UFTA, especially if Kentucky's general anti-preference law is also recommended to be repealed.

Uniformity for its own sake is not necessarily a good thing, and before the UFTA is embraced as a solution, it should be considered whether other non-uniform modifications to fraudulent transfer laws would be an even better improvement. However, even critics of the NCCUSL recognize that uniformity in commercial laws, such as the UFTA, can be advantageous.¹⁶⁵

Overall, the UFTA obviously is not a perfect statute, but it provides certainty and uniformity, both of which are advantageous in creditor-debtor law. And even if the UFTA is not perfect, few would likely rise to defend the existing Kentucky law. The statute has not been carefully examined in a hundred years, if ever. The interpretive decisions are likewise old, and typically arise in noncommercial settings that are of little help to the modern commercial practitioner. Although the UFTA has been criticized for imperfectly responding to modern transactions such as intercorporate guarantees and leveraged buyouts,¹⁶⁶ it is difficult to fathom how a court would begin such an analysis independently with only the guidance of Kentucky's antique laws.

Perhaps no change has been made because there has been very little reason to do so, considering the costs of organizing and procuring a change in the laws. However, by adopting the UFTA, there would be very little work to do. The statute has been accepted after careful study in many states.¹⁶⁷ This is not to suggest that further study should not be done before

¹⁶² See UFTA § 5, 7A U.L.A. 247 (Supp. 1997) (Hawaii and Oregon).

¹⁶³ See *id.* (Arizona, California, Indiana, and Pennsylvania).

¹⁶⁴ See *Indiana State Bar Ass'n Report*, *supra* note 133, at 1205-07.

¹⁶⁵ See Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEGAL STUD. 131, 150 (1996); see also *supra* note 152 (discussing reasons for uniformity offered by the NCCUSL when the UFCA was promulgated).

¹⁶⁶ See *supra* note 157.

¹⁶⁷ See Nathaniel Hansford, *Fraudulent Conveyances: Alabama Common Law vs. the Uniform Fraudulent Transfers Act – An Opening Discussion*, 16 CUMB. L. REV. 1 (1985); *Indiana State Bar Ass'n Report*, *supra* note 133; Commentary by The North Carolina Bar Ass'n, *supra* note 130.

the UFTA is considered for adoption in Kentucky. In particular, Kentucky should carefully consider whether the UFTA reaches too broadly.¹⁶⁸ But even before that study is done, we already have a fairly good idea of what the broad outlines of the result should be.

Recent federal legislation supplied the incentive for meaningful reform missing in the day-to-day work of the collections lawyer, but the opportunity yielded unhelpful results. Federal welfare reform legislation passed in 1996¹⁶⁹ requires that states have plans for enforcement of child and spousal support orders in order to receive "Family Assistance Grants,"¹⁷⁰ which replace payments under Aid to Families with Dependent Children.¹⁷¹ One required element of a state plan is adoption of the UFCA or UFTA or "another law, specifying indicia of fraud which create a prima facie case that a debtor transferred income or property to avoid payment to a child support creditor, which the Secretary finds affords comparable rights to child support creditors."¹⁷² Kentucky responded not by adopting one of the uniform acts as suggested by the federal law, but with enabling legislation allowing "indicia of fraud" to be set forth in regulations of the Cabinet for Families and Children.¹⁷³ While the language is inartful at best,¹⁷⁴ it is apparently adequate for purposes of the federal legislation requiring an

¹⁶⁸ See, e.g., Alces & Dorr, *supra* note 8; Baird & Jackson, *supra* note 155; Zaretsky, *supra* note 157, at 1165 n.3.

¹⁶⁹ Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 110 Stat. 2105 (1996) (codified as amended in scattered sections of 42 U.S.C.). I am indebted to Jerry Hartzell of the North Carolina bar for citing me to this Act.

¹⁷⁰ *Id.* § 103(a)(1), 110 Stat. at 2113-16 (codified at 42 U.S.C. § 601).

¹⁷¹ See *id.* § 116(b)(1)(C)(ii), 110 Stat. at 2183 (codified at 42 U.S.C. § 601).

¹⁷² *Id.* § 364, 110 Stat. at 2249 (codified at 42 U.S.C. § 666(g)). This type of state law is required of an effective state plan pursuant to 42 U.S.C. § 654(20)(A).

¹⁷³ See H.B. 161, § 24, 98 Reg. Sess. (Ky. 1998), which added the following language to section 405.060(2) of the Kentucky Revised Statutes:

In any case where an obligor transfers income or property to avoid payment to a child support creditor, the transfer shall be indicia of fraud. Indicia of fraud creates a prima facie case that the transfer of income or property was to avoid payment of child support. Indicia of fraud shall be set forth by administrative regulation.

This bill was signed by the Governor on April 2, 1998. See the unofficial legislative history at *HB/161* (visited Apr. 7, 1998) <<http://www.lrc.state.ky.us/record/98rs/HB161.htm>>.

¹⁷⁴ The transfer itself cannot actually be considered an indicator of fraud, as the statutory language quoted in the preceding note suggests.

effective state plan.¹⁷⁵ It does nothing to assist the ordinary commercial cases, because the right to avoid the transfer extends only to the wife and child who were defrauded or whose rights were hindered.¹⁷⁶

B. Preferences

The Kentucky anti-preference law is even more peculiar. Such statutes were always in the minority, with the widely accepted "black letter" rule being that a debtor has a right to pay a creditor at any time, regardless of the effect on other creditors.¹⁷⁷ Most states have anti-preference statutes that apply in the context of general or special collective proceedings for the benefit of creditors, but that is exactly where one would expect such a rule. In that instance, the race of the diligent has been suspended, and such diligence should no longer be rewarded.

It is possible that Kentucky's anti-preference statute was meant originally to be such a statute, to provide a method for an "involuntary" assignment for the benefit of creditors, much like involuntary bankruptcy, which was the only type of bankruptcy known at the time the Kentucky law was passed.¹⁷⁸ This argument, however, seems inconsistent with Kentucky's later general assignment law,¹⁷⁹ which provides for an explicit involuntary action upon petition of creditors.¹⁸⁰ The ability to set aside pre-

¹⁷⁵ Telephone Interview with Pat Patterson, Kentucky Cabinet for Families and Children (Apr. 1, 1998).

¹⁷⁶ See H.B. 161, § 24, 98 Reg. Sess. (Ky. 1998) (amending KY. REV. STAT. ANN. § 405.060 (1994)).

¹⁷⁷ [F]ew states have statutes similar to our one as embodied in . . . [KY. REV. STAT. ANN. §§ 378.060] et seq., and prior to their enactment in jurisdictions adopting them, and in all other jurisdictions not adopting them, it was and is lawful for a debtor to prefer his creditor, and it was only for the providing for a pro rata benefit to be reaped by all of his creditors that such statutes were enacted.

Tipton's Adm'x v. Ball, 77 S.W.2d 50, 52 (Ky. 1934); accord *Fawcett's Assignee v. Mitchell, Finch & Co.*, 117 S.W. 956, 958 (Ky. 1909) ("Except for our statute, there is nothing illegal in the act of preferring one creditor over another.").

¹⁷⁸ There was a brief experiment with voluntary bankruptcy in the Bankruptcy Act of 1841, but it quickly proved unpopular and was repealed 18 months later. See RIESENFELD, *supra* note 29, at 457.

¹⁷⁹ See 1894 Ky. Acts ch. 83 (codified as amended at KY. REV. STAT. ANN. §§ 379.010-.170 (Michie 1972 & Supp. 1996)).

¹⁸⁰ See KY. REV. STAT. ANN. § 379.170 (Michie Supp. 1996).

assignment transfers is provided there, as the assignee may use in that case "any remedy which a creditor might exercise,"¹⁸¹ and courts have held these provisions complementary and not inconsistent.¹⁸² Since the general assignment statute is more recent¹⁸³ and provides detailed rules for administration of the estate, it seems peculiar at best to retain an earlier statute dictating, as the anti-preference statute does, that the preference shall operate as such an involuntary assignment, to be administered as a decedent's estate would be.¹⁸⁴

In any event, these statutes are of little importance except in the few situations where relief under the Code is not possible or practical. It is highly unlikely that a preference would be set aside as an assignment for the benefit of creditors or even in a general assignment today. If followed literally, the anti-preference law's assignment of the preference for the benefit of all creditors could be considered grounds for involuntary bankruptcy under Code § 303(h)(2),¹⁸⁵ if the requisite number and type of creditors join in such a petition.¹⁸⁶ The deemed general assignment would also elevate federal claims under the federal priority statute.¹⁸⁷ In any event,

¹⁸¹ *Id.* § 379.070 (Michie 1972).

¹⁸² *See* Tipton's Adm'x v. Ball, 77 S.W.2d 50, 51 (Ky. 1934); Hall's Assignees v. Rothchild, 44 S.W. 108 (Ky. 1898).

¹⁸³ The general assignment law was passed in 1894. *See supra* note 179. The anti-preference statute was passed in 1856. *See supra* note 84 and accompanying text.

¹⁸⁴ *See* KY. REV. STAT. ANN. § 378.070 ("The action . . . shall be conducted as are actions and proceedings for the settlement of the estates of deceased persons, insofar as they are applicable.").

Of course, if the anti-preference statute is repealed, the ability to recover preferences before a general assignment must be explicitly added to the general assignment law, because the existing statute, section 370.070, merely gives the assignee "any remedy which a creditor might exercise." *Id.* § 379.070.

¹⁸⁵ This section provides that the court shall order relief on an involuntary petition, even if controverted by the debtor, if, within four months of the petition, "a custodian, other than a trustee, receiver, or agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession." 11 U.S.C. § 303(h)(2) (1994). The anti-preference law provides for a general receiver, *see* KY. REV. STAT. ANN. § 378.080(1).

¹⁸⁶ *See* 11 U.S.C. § 303(b).

¹⁸⁷ *See* 31 U.S.C. § 3713(a)(1)(A) (1994). The assignment made by the Kentucky statute would probably not be a "voluntary" assignment under subsection (i), but is likely an "act of bankruptcy" under subsection (iii). *See supra* notes 32-

a debtor faced with any such proceeding would likely then seek refuge in a bankruptcy proceeding, if for no other reason than to obtain the discharge there provided.¹⁸⁸

The main use of the Kentucky anti-preference law seems to be under Code § 544(b), to allow a trustee in bankruptcy to reach preferences within six months of filing, rather than the three months provided for non-insider preferences under Code § 547. In addition, because of the extraordinary remedy provided – forcing essentially a general assignment – the statute provides strong bargaining ammunition outside of bankruptcy for any remaining creditor to use against a debtor who has made such a preference. This second use, however, is not one that should necessarily be respected in any policy analysis. Creditors have the legitimate threat of forcing a general assignment under state law or the Code, but only upon the prerequisites there provided.¹⁸⁹ The assignment provided by the Kentucky anti-preference statute seems more an antiquated relic than a conscious decision to allow Kentucky creditors an unusual if little-used remedy. Although this relic was incorporated in the state's general assignment statute, apparently little thought was given to the coexistence of these two remedies. This anomaly does not exist in New Mexico and Ohio. Both states retained a general anti-preference statute while adopting the UFTA, which of course contains no such provision.¹⁹⁰

There should be no place for an ability to avoid a preference outside of any collective proceeding. In theory, the entire idea of a "preference" originated with a payment in the shadow of an insolvency liquidation.¹⁹¹ The lack of any collective proceeding eliminates the need for any individual recovery, because no creditor has actually been harmed by the preference unless that creditor has been unable to collect. Individual

35 and accompanying text.

¹⁸⁸ See 11 U.S.C. § 524 (discharge of debts). "The lack of discharge limits the usefulness of an [assignment for the benefit of creditors] for any debtor who can consider a bankruptcy alternative." ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 192 (3d ed. 1996).

¹⁸⁹ See KY. REV. STAT. ANN. § 379.170(1) (Michie Supp. 1996) (providing for action brought by creditor or creditors representing one-fourth of the liabilities); 11 U.S.C. § 303(b) (setting out the requirement for type and number of creditors bringing an involuntary bankruptcy petition).

¹⁹⁰ See *supra* text accompanying notes 137-47 (discussing New Mexico and Ohio experiences).

¹⁹¹ See 2 GLENN, *supra* note 7, at 652 ("[A] wrong has been done, provided the debtor's estate is put into fair liquidation."); Countryman, *supra* note 52, at 714-15.

recovery of a preference is inconsistent with state law, which normally rewards the diligent creditor.¹⁹² And in practice, such an action would be impractical; if such a creditor were able to recover the preference and levy upon it as if it were a fraudulent transfer, the effect would simply be to substitute one preference for another.¹⁹³

C. Clarification of Professional Responsibility

Modernization of Kentucky fraudulent transfer and preference law may help lawyers with some difficult ethical problems. The Kentucky Rules of Professional Conduct ("Rules") prohibit a lawyer from counseling clients to engage or assist in conduct "that the lawyer knows is criminal or fraudulent."¹⁹⁴ This rule probably creates more uncertainty among practitioners than it should, because fraud, as defined in the Rules, "denotes conduct having a purpose to deceive."¹⁹⁵ Presumably this definition excepts conduct without a deceitful purpose which is nonetheless "deemed fraudulent" under state law.¹⁹⁶

However, any uncertainty removed by this definition of fraud is reintroduced by the Rule proscribing conduct by a lawyer "involving

¹⁹² State law puts a premium on prompt action by creditors: the first creditor to attach the debtor's property, the first creditor to execute on the property, etc. is the one most likely to be paid. Bankruptcy law, on the other hand, emphasizes equality of treatment, rather than a race of diligence.

1 DAVID G. EPSTEIN ET AL., BANKRUPTCY § 1-3(b), at 7 (1992). *See also* Countryman, *supra* note 52, at 715 (stating that preferences should be proscribed "[o]nly when the legal system provides, as an alternative to the creditors' unilateral grab-law system, a procedure for collective administration").

¹⁹³ *See supra* note 147 and accompanying text.

¹⁹⁴ KY. SUP. CT. RULE 3.130 (RULE OF PROFESSIONAL CONDUCT Rule 1.2(d)).

¹⁹⁵ *Id.* (Terminology [4]).

¹⁹⁶ Compare UFTA § 4(a)(1) (transfers avoidable if made with "actual intent to hinder, delay or defraud") with *id.* §§ 4(b) & 5(a) (transfers avoidable under some circumstances if made without receiving reasonably equivalent value). Although one of the motivations of the NCCUSL in adopting the UFTA was to provide certainty to counsel in light of then newly adopted Model Rules of Professional Conduct, *see Kennedy, supra* note 9, at 199, in this one respect, it may cause confusion because it refers to the latter transactions as "fraudulent" where older statutes merely made them avoidable without giving them the additional label of "fraudulent," *see, e.g.,* KY. REV. STAT. ANN. §§ 378.020 (gifts by debtors void, but not called "fraudulent"), 378.060 (performance operates as a general assignment, but not called "fraudulent").

dishonesty, fraud, deceit or misrepresentation.”¹⁹⁷ It is likely that this rule is intended to reach more broadly to conduct that might not be actionable as a fraudulent transfer.¹⁹⁸ Furthermore, the intent required as an element of a violation of this rule is open to question.¹⁹⁹ And in any event, “the extent of a lawyer’s obligation is seriously complicated by the requirement to protect client information. . . . The problem is obviously one that cries out for clarification”²⁰⁰ When these problems inherent in the Rules themselves are combined with the anti-preference statute, it is difficult to see any clear answer. In the presence of pleadings and court opinions commingling “fraud” with the anti-preference statute,²⁰¹ what lawyer could be sure that advice to an insolvent creditor to pay *any* debts is not professional misconduct? Enactment of a sensible fraudulent transfer law would be a long first step toward separating advice on a client’s ordinary commercial conduct from unethical behavior.

CONCLUSION

Sometimes an antique is an honored, well-worn standard that has endured because of its superior quality and workmanship. Sometimes it is simply junk that no one has bothered to throw out or replace because it hasn’t been in the way very much. I submit that Kentucky’s fraudulent transfer and preferences laws are more the latter than the former. The

¹⁹⁷ KY. SUP. CT. RULE 3.130 (RULE OF PROFESSIONAL CONDUCT Rule 8.3(c)).

¹⁹⁸ See *In re Kenyon*, 491 S.E.2d 252, 254 (S.D. 1997) (“We do not have to find fraudulent conveyances – only fraudulent or dishonest conduct.”).

¹⁹⁹ Compare *In re Taylor*, 878 P.2d 1103, 1106 (Or. 1994) (“[T]he accused must act with the intent to cheat creditors to violate that rule.”) with *In re Hockett*, 734 P.2d 877, 883 (Or. 1998) (“[A] client’s conveyance of property to avoid lawful claims of creditors would be conduct in violation of [this rule], which ‘simply stated, requires honesty.’” (quoting *In re Sedor*, 245 N.W.2d 895, 901 (Wis. 1976))).

²⁰⁰ CHARLES W. WOLFRAM, MODERN LEGAL ETHICS 722, 725 (1986).

²⁰¹ See, e.g., *W.R. Willett Lumber Co. v. Hall*, 375 S.W.2d 266, 267 (Ky. 1964) (difficulty in determining nature of claim due primarily to poorly drafted complaint); *Stephens v. Allied Bldg. Credits, Inc.*, 265 S.W.2d 60, 61 (Ky. 1954) (same); *Kincaid v. Brown’s Estate*, 262 S.W.2d 468, 474 (Ky. 1953) (preference pled as a voidable transfer); *Lyon v. Harris*, 121 S.W.2d 696, 697 (Ky. 1938) (case dismissed for failure to show fraud, even though transfer would be actionable under anti-preference statute); *Farmers’ Bank & Trust Co. v. Peters*, 11 S.W.2d 103, 105 (Ky. 1928) (same).

ancient language is difficult for lawyers and courts to decipher, and has the additional cost to society of lack of respect for laws that cannot possibly mean what they say. Granted, the costs are not highly visible in the case of these statutes, because they appear in court relatively rarely. They are, however, frequently in the background in planning and negotiating commercial transactions. The costs of removing these uncertainties need not be high, because a well-received uniform act already exists and, after suitable study, can probably be put to good use. In that way, costs for everyone can be reduced, and Kentucky law in this area could, for the first time in over a century, say what it means.